



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

# DRAFT

Date:	Enrolled	Bill No:	<a href="#">ABx1 15</a>
Tax:	Property	Author:	Hill
Related Bills:			

## BILL SUMMARY

This bill expressly provides, via uncodified legislative findings and declarations, that a purchaser of a newly constructed active solar energy system that was sold in a sale-leaseback, partnership flip structure, or other transaction, is eligible to receive the property tax new construction exclusion for the system.

## ANALYSIS

### CURRENT LAW

**New Construction Exclusion – Active Solar Energy Systems.** The California Constitution, Article XIII A, Section 2(a) requires that when real property is “newly constructed,” the new construction must be assessed for property tax purposes. An additional assessment for the increase in value from the “new construction” is added to the existing assessed value of the property. However, Article XIII A, Section 2(c)(1), grants the Legislature the authority to exclude from the definition of assessable new construction the construction or addition of any active solar energy system. Thus, with the new construction exclusion, a system can be constructed or installed without any increase in property tax liability. Section 73 of the Revenue and Taxation Code is the implementing statute for this new construction exclusion and its provisions are scheduled to be repealed on January 1, 2017.

**Change in Ownership Triggers Reassessment.** Relevant to this bill, Article XIII A, Section 2(a) also requires the assessed value for property tax purposes to be reestablished whenever a change in ownership has occurred. Generally, after a change in ownership of real property (land and improvements), the entire property, including any portion of the property (or additional value) previously excluded from property tax under a new construction exclusion, is subject to reassessment to its current market value. However, with respect to the issue giving rise to this bill, the entire property is not undergoing a change in ownership. Rather, the active solar energy system itself is being sold. Under existing law, a sale of the system doesn’t require the underlying real property to be reassessed.

**Systems Installed but not owned by Property Owner - Systems Sold Apart from the Real Property.** Existing law is silent with respect to the application of the new construction exclusion when a solar energy system is newly installed or constructed and the system itself, but not the property upon which it is constructed, is sold or transferred.

A common practice by builders and developers of solar systems allows property owners to have solar systems installed at their location with no upfront or ongoing maintenance cost. To do this, the system must be sold to a third party and the property owner enters into a power purchase agreement to buy the power generated from the system located on their property. Thus, the real estate owner neither owns nor operates the system that is newly constructed upon his or her property.

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For example, these systems are built and installed by solar energy system developers and then sold or transferred to purchasers that are eligible for federal tax benefits in a sale-leaseback arrangement. The developer leases the system back from the purchaser (a tax investor) and maintains and operates it on behalf of the real estate owner who buys the power generated from the system. An alternative technique of installing systems at no cost to the property owner uses a “partnership flip” structure.

**Solar Energy Systems Incorporated in Initial Construction – Exclusion Extended to Initial Purchaser.** As noted in Section 1(a) of this bill, Section 73 was amended in 2008 (AB 1451, Stats. 2008, Ch. 538, Leno) to extend the new construction exclusion after a change in ownership if a new building is initially constructed with a solar energy system incorporated and subsequently sold by the developer. Specifically, in the case where a solar energy system is incorporated by an owner-builder in the initial construction of a new building that the owner-builder does not intend to occupy or use (i.e., a building offered for sale, such as a new home in a subdivision or a new warehouse), the exclusion for the system applies to the building’s first buyer if (1) the owner-builder did not request and receive the exclusion for the same system and (2) if the initial buyer purchased the new building prior to that building becoming subject to reassessment to the owner-builder, as described in subdivision (d) of Section 75.12.

If the exclusion is eligible to be extended to the initial purchaser, then in determining the base year value to be established as a result of the change in ownership, the base year value is reduced by the portion of the purchase price that is attributable to the active solar energy system. Thereafter, any subsequent change in ownership of the property ends the exclusion of the value of the active solar energy system from property tax.

#### PROPOSED LAW

**Financing Mechanisms Requiring Sale of Newly Constructed System.** With respect to the new construction exclusion for active solar energy systems this bill makes Legislative findings and declarations that in cases where a newly constructed active solar energy system is sold in sale-leaseback arrangements, partnership flip structures, or other transactions, the property tax exclusion for solar energy systems of Section 73 applies provided (1) the system is newly constructed or added and (2) no other taxpayer has received the exclusion for that same system.

As noted above, the mechanism used to finance the initial construction of the system at no cost to the property owner requires the system to be sold to a purchaser that can take advantage of federal tax benefits.

**Installation Methods.** This bill also makes findings and declarations that the following systems qualify under Section 73: (1) systems constructed as freestanding or parking lot canopies and (2) systems constructed or installed on existing buildings. Further, the aforementioned types of systems sold in sale-leaseback transactions qualify.

**Declaratory of Existing Law.** Section 1(d) of the bill provides that the amendments made to Section 73 do not constitute a change in, but are declaratory of, existing law. Those amendments to Section 73 add subdivisions (f) and (i)(2). Subdivision (f) provides that the exclusion from new construction provided by this section shall remain in effect only until there is a *subsequent* change in ownership. That is, a change in ownership subsequent to a transaction such as that described in the legislative findings and declarations. Subdivision (i)(2) provides that a system that qualifies for an exclusion prior to the repeal of Section 73 continues to remain excluded after the provision is repealed until there is a subsequent change in ownership.

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The amendments to Section 73 also add the phrase “upon completion of the construction of a system as part of a new property or the addition of a system to an existing property” to the definition of “active solar energy system” in subdivision (b)(1). As this is a definitional provision of what types of systems qualify and as this amendment is declaratory of existing law, this does not affect the application of the new construction exclusion to construction in progress that will, when complete, meet the definition.

**Effective Immediately.** Section 4 of the bill provides that in order to timely clarify the application and requirements of the real property exclusion for active solar energy systems, the bill is to take effect immediately.

#### IN GENERAL

**Property Tax System.** Article XIII, Section 1 of the California Constitution provides that all property is taxable, at the same percentage of “fair market value,” unless specifically exempted, or authorized for exemption, within the Constitution. Article XIII A, Section 2 of the California Constitution defines “fair market value” or “full cash value” as the assessor's opinion of value for the 1975-76 tax bill, or, thereafter, the appraised value of property when purchased, newly constructed, or a change in ownership has occurred. This value is generally referred to as the “base year value.” Barring actual physical new construction or a change in ownership, annual adjustments to the base year value are limited to 2% or the rate of inflation, whichever is less. Article XIII A, Section 2 provides for certain exclusions from the meaning of “change in ownership” and “newly constructed” as approved by voters via constitutional amendments.

**New Construction.** The constitution does not define the terms “new construction” or “newly constructed.” Revenue and Taxation Section 70 defines these terms, in part, to mean:

Any addition to real property, whether land or improvements (including fixtures), since the last lien date.

Any alteration of land or any improvements (including fixtures) since the last lien date that constitutes a “major rehabilitation” or that converts the property to a different use.

A major rehabilitation is any rehabilitation, renovation, or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture.

With respect to any new construction, the law requires the assessor to determine the added value upon completion. The value is established as the base year value for those specific improvements qualifying as “new construction” and is added to the property's existing base year value. When new construction replaces certain types of existing improvements, the value attributable to those preexisting improvements is deducted from the property's existing base year value. (R&T Code §71)

**New Construction Exclusions.** Certain types of construction activity are excluded from assessment as “new construction” via constitutional amendment. Consequently, while these improvements may increase the value of the property, the additional value is not assessable. Proposition 7, approved by California voters in November 1980, created an exclusion for active solar energy systems.

### Overview of Active Solar Energy New Construction Exclusion

An "active solar energy system" is defined in Section 73 as a system that uses solar devices, which are thermally isolated from living space or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy. Such a system does not include solar swimming pool heaters, hot tub heaters, passive energy systems, or wind energy systems.

An active solar energy system may be used for any of the following:

- Domestic, recreational, therapeutic, or service water heating.
- Space conditioning.
- Production of electricity.
- Process heat.
- Solar mechanical energy.

An active solar energy system includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functioning of those items. "Parts" includes spare parts that are owned by the owner of, or maintenance contractor for, an active solar energy system for which the parts were specifically purchased, designed, or fabricated for installation in that system. Such a system includes only equipment used up to, but not including, the stage of transmission or use of the electricity.

An active solar energy system also includes pipes and ducts that are used *exclusively* to carry energy derived from solar energy. Pipes and ducts that are used to carry *both* energy derived from solar energy and energy derived from other sources may be considered active solar energy system property only to the extent of 75 percent of their full cash value.

An active solar energy system does not include auxiliary equipment, such as furnaces and hot water heaters, that use a source of power *other* than solar energy to provide usable energy. Dual use equipment, such as ducts and hot water tanks, that is used by both auxiliary equipment and solar energy equipment is considered active solar energy system property only to the extent of 75 percent of its full cash value.

### COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by Sun Edison. According to the author, "[t]his bill is necessary because there is uncertainty in Revenue and Taxation Code 73 as it relates to the current exclusion from property tax reassessment for purchases of new "active solar energy systems" that are sold in first owner sale-leaseback arrangements. Even though sale-leaseback arrangements on solar energy systems have been utilizing the property tax exclusion for years under existing law, some have argued that there might be ambiguity in the law and it should be clarified. ABx1 15 provides this clarity and reaffirms existing law so solar projects can continue to receive the tax assessment exclusion."
2. **Sale-Leaseback and Similar Financing Transactions.** The ambiguity referenced by the author relates to the issue that, typically, a new construction exclusion remains in effect until a property changes ownership, at which point the entire property, including the portion of the property (or additional value) previously exempted from taxation under the new construction exclusion, is reassessed at its current market value pursuant to the change in ownership provisions of Proposition 13. However, in situations where an active solar energy system is sold in a sale-leaseback arrangement or partnership flip structure arrangement, the entire property is *not* undergoing a change in ownership. The uncoded legislative findings and

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declarations of this bill would ensure that assessors recognize the current exclusion for new active solar energy systems that are sold in first-owner sale-leaseback, partnership flip, or other transactions.

3. **In the case where a building is built for immediate sale, existing law expressly provides that the exclusion would continue to apply to the initial purchaser of the building.** Without the provisions added by AB 1451 (Stats. 2007, Ch. 538, Leno), the new construction exclusion would have been ineffectual for any new building that is not intended to be occupied or used by the owner-builder. Once a building is sold (i.e., changes ownership), the entire property must be reassessed to its current market value for purposes of Proposition 13. Allowing the exclusion to be extended when it was not claimed by the original owner-builder falls within the spirit of the existing constitutional authorization to exclude from property tax the value added by active solar energy systems.
4. **Subsequent Changes in Ownerships.** Newly added subdivision (f) of Section 73 provides that the exclusion from new construction provided by this section is to remain in effect only until there is a *subsequent* change in ownership. To read this in harmony with the provisions in the legislative findings and declarations concerning sale-leaseback and partnership flip transactions, this means a change in ownership *subsequent* to a transaction such as that described in the legislative findings and declarations.
5. **Installation Methods.** The Legislative findings and declarations related to installation methods provide that the exclusion applies to (1) systems constructed as freestanding or parking lot canopies and (2) systems constructed or installed on existing buildings. This is consistent with existing administrative practices.
6. **Construction in Progress.** The amendment to Section 73(b)(1) adds the phrase “upon completion of the construction of a system as part of a new property or the addition of a system to an existing property” to the definition of “active solar energy system.” As this is a definitional provision of what *types* of systems qualify, and as this bill provides that the amendments to Section 73 are declaratory of existing law, this bill does not affect the allowance of the new construction exclusion to construction in progress that will, when complete, meet the definition.
7. **Repeal of Section 73.** Newly added subdivision (i)(2) of Section 73 provides that a system that qualifies for an exclusion prior to the repeal of Section 73 continues to remain excluded after the provision is repealed until there is a subsequent change in ownership. This is consistent with the treatment of any new construction exclusion that includes a sunset date. For those unfamiliar with the intricacies of California property tax law, there can be a general perception that a solar energy system currently excluded from assessment will become subject to property tax once the exclusion sunsets. This perception must be overcome by those working towards encouraging investments in solar energy in California over the long term. To be clear, the repeal of Section 73 does not make a system that is benefiting from the exclusion immediately taxable. Thus, should Section 73 be repealed on January 1, 2017, a solar system that previously received the new construction exclusion will not become assessable, absent any other change in circumstances.
8. **Section 73 is not a real property tax “exemption” for solar energy systems, it is a new construction “exclusion.”** The new construction exclusion was created in 1980 via Proposition 7 to provide that the construction or addition of an active solar energy system to an existing property, by itself, would not lead to a revaluation of the

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property for property tax purposes. The distinction between an exclusion and an exemption is important for several reasons: (1) the exclusion terminates if there is a transfer of the property resulting in change in ownership of the property (a reappraisal event), (2) the exclusion does not apply to any property that is under the assessment jurisdiction of the BOE – any such facility would be subject to state assessment, and (3) in the case of any locally assessed large scale solar project only the “improvements” are eligible for the exclusion, the land remains subject to property tax. (Note: if the land is government owned, the land could become subject to property tax as a possessory interest. Generally, a taxable possessory interest exists when a taxpayer possesses an interest in government real property that is durable, independent, and exclusive of the rights held by others in the real property and the interest provides a private benefit to the possessor).

### **COST ESTIMATE**

The BOE would incur some minor absorbable costs in informing and advising county assessors, public and staff of the new provisions of the new construction exclusion.

### **REVENUE ESTIMATE**

This bill has no revenue impact. The Legislative findings and declarations, with respect to the treatment of a newly constructed system that is sold, are consistent with current assessment practices as are the provisions related to installation methods. With respect to the statutory amendments to Section 73, the bill expressly provides that these amendments are declaratory of existing law.

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